

Message Text

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TAGS: EFIN, ECON, BL

SUBJECT: IMF REP'S VIEW OF 1975 GOB FISCAL ENVIRONMENT

SUMMARY. IN EMBOFF CONVERSATION WITH IMF REP ON 1975 TREASURY BUDGET, REP EXPRESSED THE VIEW THAT THE POLITICAL AMBIANCE WAS SUCH THAT MAJOR POLICIES TO REDUCE POTENTIAL UNFINANCED DEFICIT WOULD NOT BE UNDERTAKEN UNLESS DETERIORATION IN PRICE STABILITY AND B/P BECAME PATENTLY EVIDENT TO GOB OFFICIALS WHO, IMF REP BELIEVES, ARE MORE CONCERNED WITH POLITICAL FALL-OUT OF SUCH BUDGET-CORRECTIVE DECISIONS AS INCREASED GASOLINE PRICES, ETC. IMF REP STATED THAT HE PRIMARILY GIVING TECHNICAL ADVICE ON MONETARY IMPLICATIONS OF FISCAL DEFICIT WHICH HE BELIEVES WILL BEGIN TO BE DESTABILIZING IN MID-JUNE, 1975, PRIMARILY BECUASE OF FINANCING REQUIREMENTS FOR 14TH MONTH SALARY NORMALLY PAID MID-JUNE. MORE-OVER, HE EXPRESSED CONCERN OVER POSSIBLE TURN AROUND IN B/P IN JUNE DUE TO EXOGENOUS FACTORS. THESE COMBINED WITH EVIDENT FISCAL DETERIORATION, HE THINKS, MAY CAUSE RASH AND POSSIBLY ILL-INFORMED POLICY DECISIONS. HIS STATED CURRENT PREOCCUPATION IS STRUCTURING A MONETARY POLICY WHICH WOULD FINANCE FISCAL DEFICIT WHILE LESSENING IMPACT OF THIS DEFICIT ON CREDIT AVAILABILITY TO PRIVATE SECTOR WHICH, IF INADEQUATE, COULD RESTRICT REAL ECONOMIC ACTIVITY. ALTHOUGH IMF REP NOT SPECIFIC AS TO POLICIES HE IS CONSIDERING OR

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ADVISING ON, IT WAS CLEAR TO EMBOFF THAT GIVEN LIMITED NUMBER OF

MONETARY INSTRUMENTS AVAILABLE, HE PROBABLY HAD IN MIND MORE FLEXIBLE USE OF INTEREST RATES. HE DID STATE THAT ATTRACTION OF SAVINGS TO BANKING SYSTEM WOULD PERMIT NON-INFLATIONARY CREDIT EXPANSION AND GIVE CENTRAL BANK MORE FLEXIBILITY IN DEALING WITH TREASURY DEFICIT. END OF SUMMARY.

1. IMF REP INDICATED THAT HE BELIEVED UNFINANCED 1975 DEFICIT OF ABOUT \$B800 MILLION WAS LIKELY. HE ALSO BELIEVED THAT GOB MAY AUTHORIZE A PUBLIC SECTOR SALARY INCREASE OF ABOUT 20 PER-CENT IN OCTOBER, 1975 CAUSING ADDITIONAL FINANCING PROBLEMS. HE SAID GOB WOULD PROBABLY TAKE SOME MARGINAL TAX MEASURES, SUCH AS AN INCREASE OF THREE PERCENTAGE POINTS IN SALES TAX AND INCREASES IN AUTOMOBILE AND STAMP TAXES WHICH TOGETHER MAY RAISE \$B 150 MILLION. THESE DECISIONS, HE THOUGHT, WERE POSSIBLE BY JUNE, 1975. IF SALARY INCREASE DECISION TAKEN IN OCTOBER, HE THOUGHT GOB MIGHT THEN RAISE PRICE ON GASOLINE AND OTHER DOMESTICALLY CONSUMED PETROLEUM PRODUCTS. HE SAID TECHNICAL ISSUE HAD BEEN RESOLVED BUT POLITICAL JUDGEMENT IN FAVOR OF SUCH ACTION HAD NOT YET BEEN MADE.

2. IMF REP ESTIMATED THAT B/P DEFICIT WOULD PROBABLY BE IN AREA OF US \$40 MILLION FOR 1975, BUT CAUTIOUSLY NOTED LAG EFFECT COULD LESSEN DEFICIT IN 1975 BUT CARRY OVER INTO 1976. HE FELT COMBINATION OF LOWER EXPORT LEVELS, DUE TO LOWER WORLD PRICES AND POSSIBLE FURTHER DECLINE IN VOLUME, AND HIGHER IMPORT REQUIREMENTS WERE MAIN CAUSE OF DETERIORATION, EVEN THOUGH HIGHER CAPITAL INFLOWS WOULD TAKE PLACE IN 1975 TO FINANCE IMPORTS.

3. HE EXPRESSED HIS MAIN PREOCCUPATION AS BEING MONETARY IMPACT OF THE FISCAL DEFICIT ON PRIVATE SECTOR'S ABILITY TO OBTAIN FINANCING WITHOUT DESTABILIZING PRICE EFFECTS. CENTRAL BANK, HE FEELS, CAN NOT AVOID FINANCING THE DEFICIT AND, MOREOVER, HAS LITTLE CONTROL OVER LIKELY DRAWDOWN OF CENTRAL BANK DEPOSITS OF PUBLIC ENTERPRISES AND AUTONOMOUS AGENCIES. (THE INCREASE IN THEIR DEPOSITS CONTRIBUTED TO OFFSETTING B/P SURPLUS EFFECT ON MONEY SUPPLY IN 1974.) THESE TWO FACTORS COMBINED WILL AUTOMATICALLY LEAD CENTRAL BANK TO TIGHTEN SCREWS ON PRIVATE CREDIT OR AT LEAST SEVERELY LIMIT EXPANSION. IMF REP APPEARS TO BELIEVE THAT A MORE POSITIVE INTEREST RATE POLICY FOR THE BANKING SYSTEM WOULD BE NECESSARY TO ATTRACT SAVINGS TO EXPAND NON-INFLATIONARY CREDIT AVAILABILITY FOR THE PRIVATE SECTOR.

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4. IMF REP HAD VERY FEW OTHER OBSERVATIONS TO MAKE, EXCEPT TO STATE THAT GOB FULLY AWARE OF PROBLEM. COMMENT: MISSION OBSERVERS ARE IN AGREEMENT THAT FISCAL DEFICIT (VIZ., UNFINANCED ELEMENT) IS SUBSTANTIAL, UNLESS GOB TAKES MAJOR TAX MEASURES OR SUBSTANTIALLY CUTS EXPENDITURES. INVESTMENT EXPENDITURES PROBABLY WOULD RECEIVE MOST OF CUTS, CRIPPING DEVELOPMENT EFFORTS. OCTOBER SALARY ADJUSTMENT FOR PUBLIC SECTOR BY GOB IS STILL FAR DOWN THE PATH AND

MAY NOT COME TO FRUITION (WE THINK JANUARY, 1976 IS MOST PROBABLE DATE FOR ANY PUBLIC SECTOR SALARY INCREASE). MORE FLEXIBLE POLICY ON INTEREST RATE STRUCTURE WHICH WOULD ALLOW AN INCREASE IN INTEREST ON SAVINGS AND MIGHT INCLUDE INTEREST RATE INCREASE ON LOANS WOULD BE A POSITIVE STEP, BUT WE BELIEVE UNLIKELY AS BANKERS CONSIDER SAVINGS RATES ALREADY HIGH AND GOB WOULD RESIST SUCH A COST INCREASE. A FREEZE ON PORTION OF AUTONOMOUS AGENCY DEPOSITS HELD IN CENTRAL BANK IS POSSIBLE AND COULD KEEP MONETARY EXPANSION WITHIN ACCEPTABLE LIMITS. THE MAGNITUDE OF B/P DEFICIT IS UNCERTAIN, ESPECIALLY AS OIL PRICE NOT YET SET, BUT US \$30 - US \$40 MILLION APPEARS WITHIN BALL PARK FOR 1975. DOMESTIC INFLATION WILL PROBABLY DECLINE RELATIVE TO 1974 BUT STILL WILL BE 20 PER-CENT AND POSSIBLY MORE IN 1975. ALTHOUGH THESE FACTORS INDICAE A REVESAL FROM THE FAVORABLE 1974 ENVIRONMENT, THE MISSION BELIEVES THAT THE GOB RETAINS THE FLEXIBILITY TO INTRODUCE CORRECTIVE MEASURES, PARTICULARLY WITH F/X RESERVES AT A HISTORICAL HIGH.

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